Naval Audit Service

Fraud Indicators Used in Audit

American Society of Military Comptrollers

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Purpose

- Fraud Risk Assessments
- Fraud Indicators
- Fraud in the Department of the Navy

GAO Yellow Book

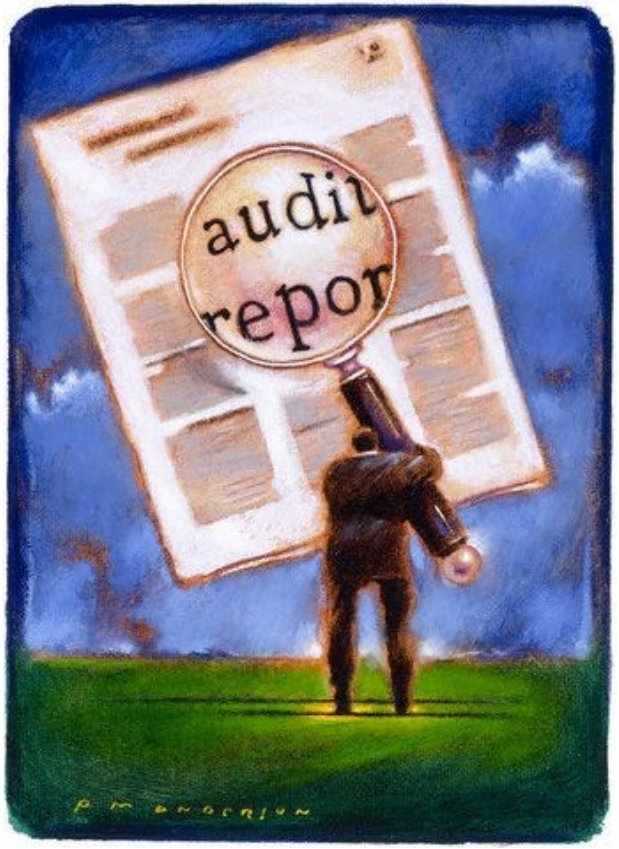
Chapter 7:

Field Work Standards for Performance Audits

...In planning the audit, auditors should consider risks due to fraud that could significantly affect their audit objectives and the results of their audit.

Audit Standards Require

- As part of performance audits:
  - Conduct & Document Fraud Risk Assessment
  - If potential for fraud risk exists –
    - Design & perform audit procedures to provide reasonable assurance of detecting illegal acts or violations of law



Fraud Risk Assessment

- Gather information to assess vulnerability of area to fraud
- Exercise professional skepticism & judgment
- Identify opportunities, incentives or attitudes conducive to fraud
- Be alert throughout the audit to indicators of fraud

Don't be afraid to see what you see – Facts are stubborn things – Ronald Reagan

NAVAUDSVC Fraud Risk Matrix

- Developed to Aggressively Implement GAO's Fraud Risk Assessment Requirement
- Applied to All Audits
- Determines:
  - Whether Fraud is Potentially Significant to Audit Objectives
  - Fraud Audit Steps to Focus on Specific Areas

NAVAUDSVC Fraud Risk Matrix (con't.)

Consideration of Risk Due to Fraud	If "Y(es)," the risk of fraud is relevant and potentially significant to the audit objectives
In the team's judgment, is the program or activity covered by the audit objectives susceptible to a significant risk of fraud from: • Misappropriation or misuse of program assets; or • Misstatement or misrepresentation of program information or results in order to obtain or continue receiving government funding or benefits?	Y N
Has the team identified indications of potential fraud in areas that fall outside the audit objectives that could have a significant impact on program or function operations or reputation? (Use the same indicators discussed in question 2 in making this assessment.)	Y N
Has the team identified strong indications that potential fraud actually occurred, regardless of significance to the audit objectives, that could pose a reputation risk to the DON if exposed to the public?	Y N

NAVAUDSVC Fraud Risk Matrix (con't.)

Consideration of Risk Due to Fraud	If "Y(es)," the risk of fraud is relevant and potentially significant to the audit objectives
Has the team identified conditions, such as the following, that might indicate a heightened risk of fraud? • The entity's financial stability, viability, or budget is threatened by economic, programmatic, or entity operating conditions; • The nature of the audited entity's operations provides opportunities to engage in fraud; • Poorly designed internal controls that provide the opportunity for fraud to occur and not be identified by existing management and oversight processes; • Weak management that fails to enforce existing internal controls or provide adequate oversight over the control process; • Inadequate separation of duties, especially those that relate to controlling and safeguarding resources; • Inadequate monitoring by management for compliance with policies, laws, and regulations; • The organizational structure is unstable or unnecessarily complex; • Transactions that are out of the ordinary and are not satisfactorily explained, such as unexplained adjustments in performance or financial information; • Repeated use of sole source contracting; • Instances when employees of the audited entity refuse to take vacations or accept promotions; • Lack of communication and/or support for ethical standards by management; • Management has a willingness to accept unusually high levels of risk in making significant decisions; • A history of impropriety, such as previous issues with fraud, waste, abuse, or questionable practices, or past audits or investigations with findings of questionable or criminal activity; • Operating policies and procedures have not been developed or are outdated; • Key documentation is lacking, altered, does not exist, or there are unexplained delays in providing information; • Lack of asset accountability or safeguarding procedures; • Improper payments; • False or misleading information; • A pattern of large procurements in any budget line with remaining funds at year end, in order to "use up all of the funds available"; or • Unusual patterns and trends in contracting, procurement, acquisition, and other activities of the entity or program under audit.	Y N

Poor Internal Controls

- So? We don't have great internal controls…
- My people are great…!
- I trust them implicitly…!

I Don’t Need No Stinking Internal Controls

…What Could Possibly Happen???

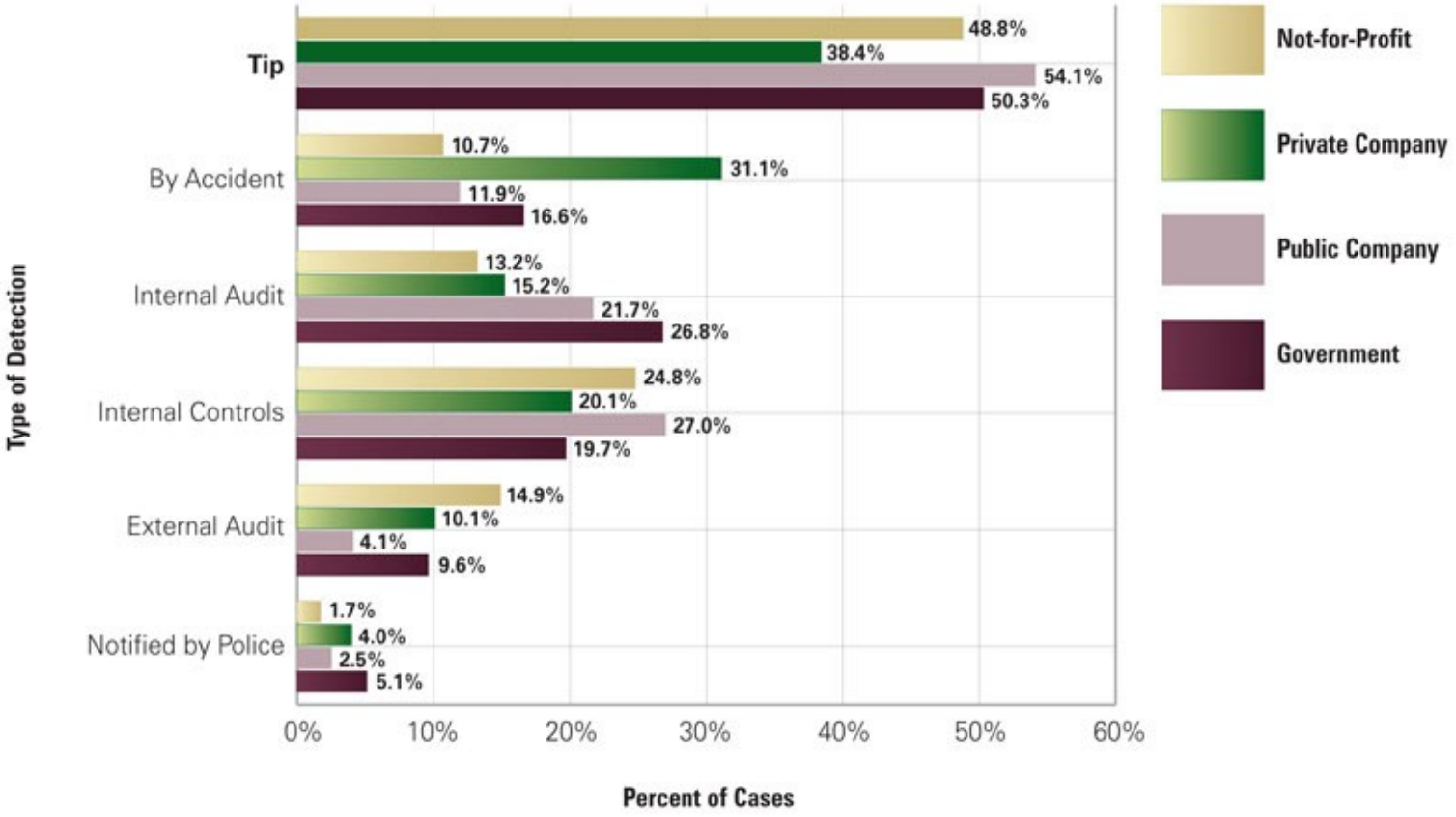
Fraud

"…A type of illegal act that involves obtaining something of value through willful misrepresentation"

**Government Accountability Office*

Detection of Fraud Schemes

Initial Detection Method by Organization Type



Note: The sum of percentages in this chart exceeds 100 percent because in some cases respondents identified more than one detection method.

Source: 2008 ACFE Report to the Nation

Detecting & Deterring Fraud

"There is no kind of dishonesty into which otherwise good people more easily and frequently fall than that of defrauding the government."

-- Benjamin Franklin

Indicators of Potential Procurement Fraud

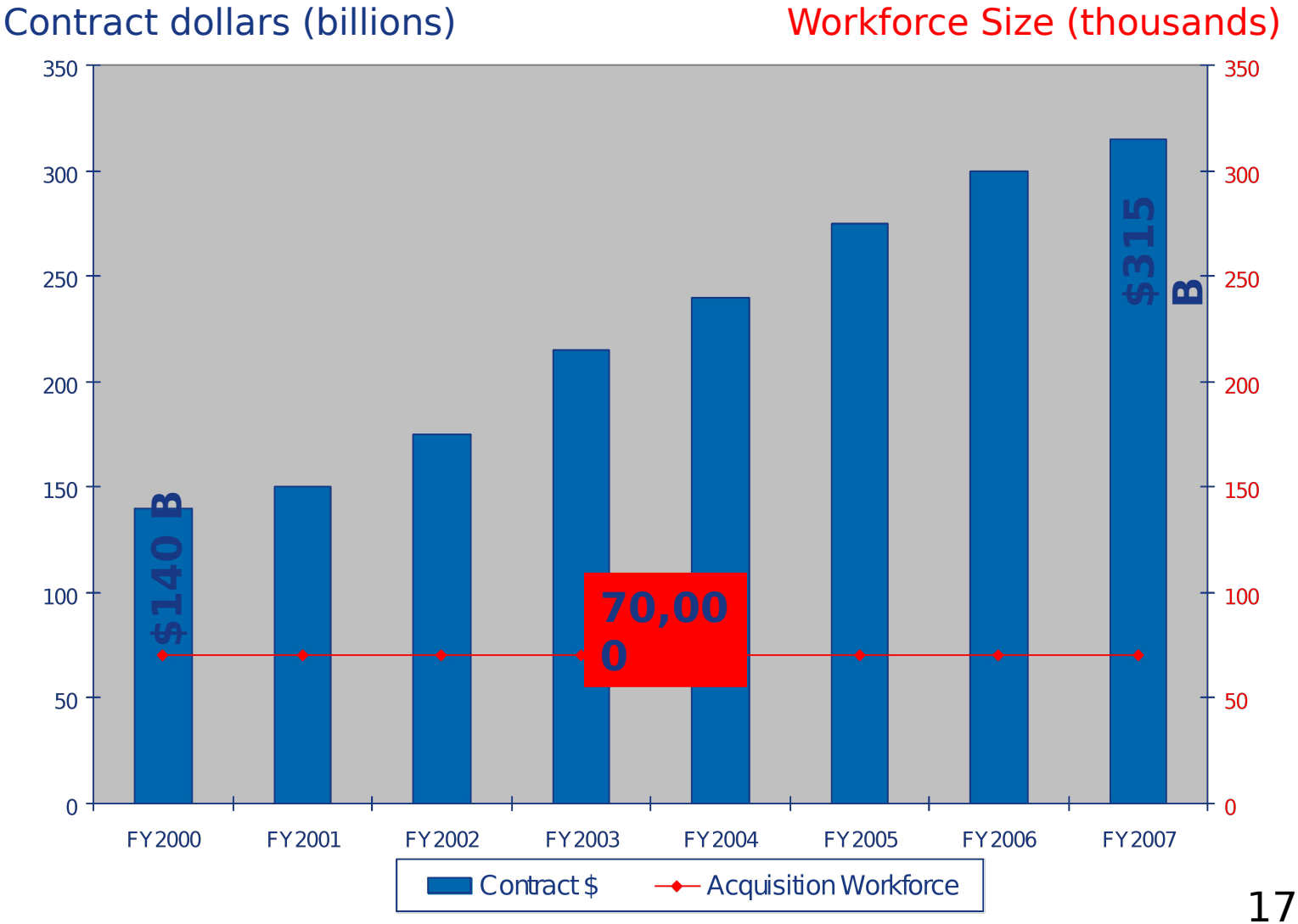
Fraud Indicators

- Uncharacteristic behavior by employees or coworkers
- Offers of gifts, money, or other gratuities from contractors, grantees or other individuals dealing with the government
- Increase in claims for reimbursement
- Appearance of conflict of interest by employees and/or contractors
- Unaccountable funds
- One person in control (e.g., no separation of duties)
- Persons living beyond their means
- Altered, inadequate or missing documentation
- Non-serial numbered transactions
- Straight Bills of Lading
- Unrealistic contract prices

Fraud Indicators (con't.)

- Persons not taking leave
- Suspicious Documents
- Theft or conversion of government property
- Persons being too cooperative
- Uncharacteristic willingness to settle claims
- Altered or erroneous changes on documents
- Vendors increasing invoices
- Fictitious vendors
- Suspicious trends
- Supporting records are unavailable or are not produced promptly
- Photocopied original records on file (i.e., no original documents available, only photocopies)
- Unauthorized personnel with access

DoD Contract Dollars & Acquisition Workforce Size



Bribes and Kickbacks

- Unexplained or unjustified favorable treatment of a particular supplier
- Unjustified high prices or explosive price increases
- Unusually high volume of purchases
- Unnecessary or inappropriate purchases
- Questionable, improper (noncompetitive), or repeated selection of a particular supplier
- Acceptance of low quality; late delivery from contractor
- Close socialization between Government officials and vendors
- Government official's acceptance of inappropriate gifts or entertainment
- Unexplained increase in wealth by Government official
- Government official with undisclosed outside business
- Supplier reputation for paying kickbacks
- Unnecessary middleman or broker involved in contracts or purchases
- Requests for sole source procurements when there is an available pool of vendors to compete the contract
- Questionable, undocumented, or frequent requests for change orders awarded to particular contractor

Naval Audit Service Fraud Support

NAVAUDSVC Fraud Support

- Contracting
- Basic Allowance for Housing/ Family Separation Housing Allowance
- Marriage Fraud
- Overtime
- Travel and purchase card
- Espionage (living beyond means)
- Ghost vendors
- Reserve drill pay
- Product & service substitution
- Travel voucher processing

Case Examples

- Reserve Training/Mobilization Orders
- BAH Fraud/Sham Marriages
- Travel Voucher Fraud

Example 1:

Reserve Training/Mobilization

- Reservists were being paid for training weekends when they were either absent or lacked record of attendance
- Mobilization orders contained false modifications or extensions, false addresses, or unapproved travel claims
- Background
  - Reservist to CO: “I was paid on annual training (AT) orders… But, I didn’t go to training!”

Example 1:

Reserve Training/Mobilization

- Methodology
  - Analyzed suspicious training and mobilization orders
    - Orders created and approved by the same person
    - Location of orders at a NOSC rather than drilling unit
    - Orders dated at the end of the FY
    - Orders containing modifications or showing recent address changes
    - Questionable justifications for extensions or modifications

Example 1:

Reserve Training/Mobilization

- Key vulnerabilities – training orders
  - Users could independently create, process and authorize orders
  - Poorly managed user roles within the order writing system
  - Unreliable approval processes
  - Unclear mission purpose on orders
  - Internal inspections had not identified any of the above weaknesses

- Key Vulnerabilities – mobilization orders
  - Modifications/extensions to orders with vague justifications
  - Address changes making member eligible for per diem payments were not challenged
  - Unapproved travel claims processed for payment

Example 2:

BAH Fraud/Sham Marriages

- Single shipboard sailors were being paid the “with dependent” BAH entitlement as a result of entering into fraudulent marriages with non-US citizens
- “Wives” did not live with the sailors but gained US citizenship while sailors received thousands of dollars in extra pay
- Background
  - Sailor to Prosecutor, “If I had only thought about it a little while longer, I wouldn’t have done it.”

Example 2:

BAH Fraud/Sham Marriages

- Methodology
  - Analyzed Leave and Earnings Statements and compared what was received to that which was entitled under normal circumstances
    - Types of pay included Basic Allowance for Housing (BAH), Family Separation Housing (FSH), and Continental US Cost of Living Allowance (CONUS COLA)
    - Sailors below E-5 were required to live in on-base quarters and only entitled to single-rate BAH

Example 2:

BAH Fraud/Sham Marriages

- Key vulnerabilities – oversight and reporting of marriages
  - Unreliable pre-approval process prior to marriage occurrence
  - Sailors did not report marriages to Security Manager or document in other personnel-related systems/programs
  - Review of required supporting documentation not consistent
  - Personnel files not periodically reviewed to identify irregularities

Example 3:

Travel Voucher Fraud

- Travel systems being manipulated to generate improper payments
- Numerous fictitious travel orders created by system administrators for personal gain
- Existing vouchers improperly amended to generate additional disbursements for previously claimed travel expenses

Example 3:

Travel Voucher Fraud

- Methodology
  - Data-mined travel system to identify and analyze suspicious travel claims and voucher amendments
    - Orders created and approved by the same person
    - Legitimate traveler information
    - Bank account information for voucher payments

Internal Control Environment

- Tone at the Top
  - Ethics & Integrity
- Established Policies and Procedures
- Clear Accountability and Responsibility
- Staffing Aligned to Workload
- Oversight

Trust But Verify

- Apply “professional skepticism”
  - Require proof
  - Examine results
  - Verify receipt
  - Physically inspect
  - Test controls & procedures
  - Validate documentation
  - Obtain/compare information from multiple sources

- If money/assets are involved in any way, potential for fraud exists

Historical Problems Pitfalls and Challenges

- Lack of contract
- Poorly defined contract requirements
- Poor or incomplete records and files
- Lack of separation of duties/functions
- Administration/Oversight
- Lack of cooperation and access
- Inadequate human resources
- US laws and regulations apply

Fraud Schemes

Accountability & Transparency

- Collusive Bidding
- Bribery/Kickbacks
- Conflict of Interest
- Commingling Contracts
- Cost Mischarging
- Defective Pricing
- Failure to Meet Specifications
- False Statements/Claims
- Product Substitution
- Process Substitution
- Phantom Vendors

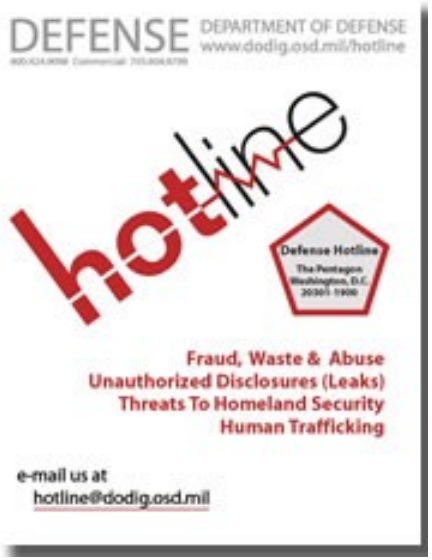
REMINDER!

- Contractors & Government Officials who choose to commit fraud
  - We are watching (NCIS, NAVAUDSVC, DoDIG, GAO, etc.)
  - Your co-workers and competitors are watching
  - Those who commit fraud cannot trust anyone
  - Numerous audit and review functions are flagging suspicious activities and transactions
  - NAVAUDSVC & NCIS are here to help *prevent* this activity from happening and to *react* when it does
  - We will catch you!
  - We will prosecute you!

Now I Get it!

Reporting Suspected Fraud

- Naval Inspector General Hotline
  - Phone: 1-800-522-3451
  - Email: NAVIGHotlines@navy.mil
- DoD Inspector General Hotline
  - Phone: 1-800-424-9098
  - Email: Hotline@dodig.osd.mil
  - Website: http://www.dodig.osd.mil/hotline



Wrap-up

- Questions
- Comments
- Thoughts

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